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In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 367

ACF-BRILL MOTORS COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 63a-82a) is reported at 14 T.C. 263. The opinion of the Court of Appeals (R. 84-91) is reported at 189 F. 2d 704.

JURISDICTION

The judgment of the Court of Appeals was entered on June 7, 1951. (R. 92.) A petition for rehearing (R. 93-98) was filed on June 21, 1951, and was denied on July 11, 1951 (R. 99). A petition for a writ of certiorari was filed on October 4,

1951. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

The taxpayer issued its stock to the stockholders of two other corporations in exchange for their shares of stock in such corporations. Some of the transferors had previously purchased some of that stock with the purpose of organizing a corporation and of having it acquire all the stock in both corporations in exchange for the issuance of its own stock. The sellers of the stock, however, were not parties to this plan.

The question is whether the taxpayer acquired the stock of these two corporations in a tax-free exchange under Section 203 (b)(4) and (h)(1)(A) of the Revenue Act of 1926.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and Regulations are set forth in the Appendix, *infra*, pp. 13-17.

STATEMENT

In 1925, the officers of the American Car & Foundry Company (called American Car) and J. G. Brill Company (called Brill), being convinced that their business of manufacturing railroad cars and equipment was on the down grade, demonstrated interest in the bus manufacturing business, and commenced activities to procure an enterprise of that kind. In June of that year, they instituted negotiations to acquire the assets

of, or the controlling interest in, the Hall-Scott Company, The Fageol Motor Company of California, and the Fageol Motor Company of Ohio. (R. 65a.) On August 28, 1925, they submitted to the directors of Fageol of California, a proposition for the consolidation of that company and Hall-Scott through the formation of a new corporation. This proposition, which was accepted by California Fageol's directors, was never carried out because not approved by its stockholders. (R. 66a.)

On August 29, 1925, American Car and Brill companies entered into an agreement with three individual stockholders of Hall-Scott Company to purchase from them 667 shares of that company's stock (out of a total of 1,000 outstanding shares) at the rate of $4,500 per share. (R. 66a.) That agreement was executed on October 31, 1925, when a subsidiary of American Car, American Car & Foundry Securities Company (called Securities) paid for the Hall-Scott stock and acquired it from those stockholders. (R. 68a-69a.)

On October 15, 1925, the majority stockholders of Fageol of Ohio (which will be called Fageol) submitted an offer to Brill Company with respect to the exchange of their stock for the stock in a new corporation to be organized. (R. 68a.)

On December 23, 1925, the taxpayer was formed as a corporation. At a meeting of its board of directors on December 31, 1925, a resolution was

passed accepting the offer of the stockholders of Fageol to exchange their preferred and common stock for common stock of the taxpayer. This was carried out in January, 1926. At the meeting of December 31, 1925, the taxpayer's directors also approved the acquisition of all the common stock of Hall-Scott Company in exchange for designated shares of common and preferred stock of the taxpayer. (R. 69a.) These exchanges were carried out in January, 1926, when the then stockholders of Hall-Scott (including Securities and Brill companies) and the stockholders of Fageol received stock in the taxpayer in exchange for their stock in Hall-Scott and in Fageol. (R. 70a-72a.)

In determining the amount of equity invested capital to be used in a consolidated return for excess profits tax purposes, the Commissioner ruled that the taxpayer had acquired the Hall-Scott and Fageol stock in a tax-free exchange, so that that stock was held on an other than cost basis. This determination was sustained by the Tax Court (R. 74a-79a) and by the Court of Appeals (R. 84-91).

ARGUMENT

1. The decision below is correct. The immediate issue is whether the taxpayer acquired the stock of two subsidiary corporations (Hall-Scott Company and Fageol Company) in a tax-free exchange, with the result that the stock of those companies would be held by the taxpayer with a tax basis

which would not be cost.[1] The Court of Appeals, sustaining the Tax Court, held that the stock was acquired by the taxpayer in a transaction in which no gain or loss was recognized under Section 203 (b)(4) and (h)(1)(A) of the Revenue Act of 1926 (Appendix, *infra,* pp. 14-15), the stock, consequently, having a basis other than cost under Section 113 (a)(7) and (8), Internal Revenue Code (Appendix, *infra,* pp. 13-14). Consideration of the relevant circumstances makes it evident that the proper result has been reached.

Shortly after its organization, the taxpayer acquired all the stock of the Hall-Scott and Fageol companies by issuing its own stock in exchange to the then stockholders of both corporations. The

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[1] The ultimate issue concerns the proper amount of equity invested capital to be included in a consolidated corporate return for excess profits tax purposes. If, as held by the courts below, the stock was acquired in a tax-free exchange so as to be held with a basis "other than cost," it is perfectly plain that the Commissioner and the Tax Court made the proper computation of equity invested capital under Treasury Regulations 110, Section 33.31 (c)(2)(iv)(F) and (G), and (13)(i)(B) (Appendix, *infra,* pp. 15-17), and the taxpayer has never before contended otherwise.

While it is now asserted (Pet. 10-11) that the result reached by the decision below contravenes the intent of the excess profits tax law, it is clear that the only real controversy centers on the tax effect in 1926 of the transaction in which the taxpayer acquired the stock of these subsidiaries; once it is determined that the basis of that stock is other than cost, the computation of equity invested capital in the consolidated return is reduced to a mathematical computation, the effect of which is to include in consolidated equity invested capital the subsidiary's original invested capital and the accumulated earnings to the beginning of the taxable year, in place of the parent's investment in the subsidiary's stock. See II Montgomery's *Federal Taxes on Corporations and Partnerships* (1946-1947), pp. 747-756.

transferors of the Hall-Scott and Fageol stock thereupon became the stockholders in control of the taxpayer; the stock interest which they received in the taxpayer as a consequence of this exchange was substantially in proportion to their previous interests in Hall-Scott and Fageol. (R. 69a-72a.) This exchange did not result in taxable gain or loss for it fits the precise language of Section 203 (b)(4) of the 1926 Act as a transfer of "property * * * to a corporation by one or more persons solely in exchange for stock or securities in such corporation * * *." It was also a tax-free "reorganization" under Section 203 (h) (1) (A) of that Act as "the acquisition by one corporation of at least a majority" of all classes of stock "of another corporation."

The taxpayer has abandoned (Pet. 7) its principal argument below, namely, that the transferors (Securities and Brill companies) who had exchanged 667 shares of Hall-Scott stock for the taxpayer's stock had, in reality, previously purchased the Hall-Scott stock on behalf of the taxpayer as its promoters. (R. 77a-78a, 87-88.) The exact reasons on which the taxpayer now relies for the continued contention that a taxable rather than a non-taxable exchange took place in 1926, are not easily ascertainable from the petition. The argument expressly advanced is that the exchange by Securities and Brill companies of their Hall-Scott stock for the taxpayer's stock should be ignored

(Pet. 7-10); the unexpressed assumption seems to be that the original Hall-Scott stockholders who sold their 667 shares to Securities and Brill in 1925, should somehow be considered as having sold that stock to the taxpayer for cash in 1926, and that the stock which the taxpayer actually issued to Securities and Brill for the Hall-Scott stock should either be ignored or considered as issued for something else. This, we further surmise, is supposed to make the tax-free provisions of the statute inapplicable by opening the way for the contention that there would have been no compliance with the control, proportionate interest, and continuity of interest requirements of the applicable statutory sections.[2]

The courts below, however, were correct in holding that there was no basis for ignoring the transactions which took place or for completely altering the substance of what the parties did. Whether Securities and Brill were actually the parties which transferred the 667 shares of Hall-Scott stock to the taxpayer in exchange for the taxpayer's stock, as the Court of Appeals observed (R. 89), was

---

[2] Section 203 (b) (4) of the 1926 Act requires that the transferors of the property (the Hall-Scott and Fageol stock here) be in control of the transferee immediately after the exchange, and that the stock and securities received by them be substantially in proportion to their previous interest in the property transferred. Also, to constitute a tax-free exchange under Section 203 (h) (1), the original stockholders must possess a continuity of interest in the business venture. *Pinellas Ice Co.* v. *Commissioner*, 287 U.S. 462; *Helvering* v. *Minnesota Tea Co.*, 296 U.S. 378; *LeTulle* v. *Scofield*, 308 U.S. 415.

basically a matter for determination by the fact-finder. Cf. *Commissioner* v. *Court Holding Co.*, 324 U.S. 331; *United States* v. *Cumberland Pub. Serv. Co.*, 338 U.S. 451. The Tax Court's conclusion that they were the transferors, both in fact and in substance, was certainly permitted if, indeed, it was not compelled by the record.

The Tax Court was not required to reach any different conclusion simply because Securities and Brill, motivated by a desire to control an integrated bus manufacturing business, may have purchased these Hall-Scott shares with the general purpose of ultimately transferring that stock and the stock in other companies to a new corporation. As the court below pointed out (R. 90), there was, at most, only a general plan, the details of which changed from time to time, and the general aspects of the plan existing when the stock was purchased were never carried out completely. The court below also agreed (R. 89-91) with the Tax Court that the transfer of the stock to the taxpayer was not an indispensable part of the plan with which the stock was purchased and that, as such, there was no reason for disregarding this or any other aspect of the transactions which took place.

Furthermore, whatever plan was being entertained by Securities and Brill when they purchased these shares, they were under no obligation to the sellers of the Hall-Scott stock, to each other, or to

the taxpayer to transfer that stock to the taxpayer. Instead, they became vested with full ownership when they bought the stock, free to do with it as they pleased; the sellers, consequently, were complete strangers to anything that Securities and Brill did thereafter. As a result, there is no basis for any conclusion that the original Hall-Scott stockholders sold their shares, not to Securities and Brill, but to the taxpayer corporation which was not even in existence at the time of the sale. The tax consequences, accordingly, must be determined by the circumstances that actually existed. *Founders General Co.* v. *Hoey,* 300 U.S. 268.

The taxpayer is mistaken in contending (Pet. 7-9) that *Helvering* v. *Bashford,* 302 U.S. 454, requires a different result. That case not only involved an altogether different statutory problem, but it presented completely dissimilar facts. There, Atlas Company, desiring to eliminate competition from three other concerns (Peerless, Union, and Black Diamond) conceived the plan of consolidating them in a single corporation which it would control. The stockholders of the competing corporations agreed to give up their stock, which was to be transferred to the new corporation, in exchange for some stock in the new corporation, some of Atlas' stock, and cash which Atlas was to supply to the new corporation. Atlas, in turn, for the cash which it supplied and its own stock which it transferred, was to receive all the pre-

ferred stock and a majority of the common stock of the new corporation.

To the extent that the stockholders of the old corporations received stock from the new corporation in exchange for their old shares of stock, the exchange was conceded to be tax-free. To the extent that they also received shares of Atlas' stock, it was held, following *Groman* v. *Commissioner,* 302 U.S. 82, that a tax-free exchange was not involved because Atlas was not a party to the reorganization.

In an attempt to avoid the *Groman* case, it was argued by the taxpayer in *Bashford* that Atlas was a party to the reorganization because it had exchanged stock which it owned in the competing companies for stock in the new company. Although the record in that case was fairly clear that Atlas had not even possessed momentary, technical title in the stock of the competing companies, this Court dismissed the argument because, in any event (p. 458) "Any direct ownership" of that stock by Atlas "was transitory and without real substance * * *." This conclusion plainly followed from the fact that there had been binding agreements with the old stockholders that their stock in, and the assets of, the competing companies would be transferred to the new corporation.[3]

[3] The taxpayer is also in error in asserting (Pet. 8) that Atlas purchased the stock "without qualification or reservation of any kind" and that the stockholders of the competing companies "did not participate in the contract or exchange between Atlas and the new company."

The situation in the *Bashford* case is thus different from the present case in every essential respect. Atlas' ownership, if any, was transitory and devoid of substance for, being obligated to transfer the stock to the new corporation, it never was free to exercise the rights of an owner. Here, as we have seen, Securities and Brill acquired ownership in every sense of that word, there being no strings or other conditions attached to their acquisition of the Hall-Scott stock. Further, in the *Bashford* case, the old stockholders had the contractual right to have their stock transferred to the new corporation so that, even if Atlas did possesss momentary title, it lacked substantial ownership, for it was a mere conduit to pass title to the new corporation, the old stockholders being the true transferors. See also *Minnesota Tea Co.* v. *Helvering,* 302 U.S. 609. Here, however, the old stockholders had no control over the shares of stock which they sold, and had no connection with the subsequent transfer of that stock to the new corporation. They, consequently, could not be viewed as having transferred the stock to the taxpayer.

Thus, even if there be overlooked the completely different problems presented by the two cases, the *Bashford* decision, where the fact situation is diametrically opposed to that of this case, does not require a contrary result.

2. The taxpayer does not contend that the deci-

sion below conflicts with that in any other circuit. While it is claimed (Pet. 7-9) that the decision here is opposed by *Helvering* v. *Bashford,* 302 U.S. 454, we have already demonstrated that the two decisions are completely harmonious.

CONCLUSION

The decision below is correct. There is no conflict in decisions. No other reasons appear which would warrant further review. The petition for a writ of certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
HILBERT P. ZARKY,
Special Assistants to the Attorney General.

NOVEMBER, 1951.

APPENDIX

INTERNAL REVENUE CODE:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(7) *Transfers to Corporation.*—If the property was acquired—

(A) after December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, or

(B) in a taxable year beginning after December 31, 1935, by a corporation in connection with a reorganization,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

(8) *Property Acquired by Issuance of Stock or as Paid-In Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b)(5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * *

(26 U.S.C. 1946 ed., Sec. 113.)

Revenue Act of 1926, c. 27, 44 Stat. 9:

Sec. 203. * * *

(b) * * *

(4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more

persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(h) As used in this section and sections 201 and 204—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or * * *

Treasury Regulations 110, promulgated under the Internal Revenue Code:

Sec. 33.31. *Bases of Tax Computation.*

* * * * *

(c) [as amended by T. D. 5245, 1943 Cum. Bull. 801, and T. D. 5327, 1944 Cum. Bull. 424] *Computations.*—

* * * * *

(2) * * *

* * * * *

(iv) In the computation of average invested capital (which, under this section, may be a minus amount), the following adjustments shall be made—

* * * * *

(F) With respect to the stock of another member of the affiliated group held with a basis for invested capital purposes determined to be a basis other than cost, there shall be subtracted from equity invested capital otherwise computed an amount equal to such basis adjusted by an amount equal to the adjustments proper under section 115 (l) for determining earnings and profits, except that no adjustment shall be made with respect to—

* * * * *

(G) In the case of a member of the affiliated group the stock of which is held by other members of such group with a basis for invested capital purposes determined to be a cost basis, there shall be excluded as of the date on which such corporation became a member of the group within the meaning of section 141 (d) of the Code that portion of its equity invested capital attributable to the shares of stock so held * * *

* * * * *

(13) For the purpose of computing the consolidated average invested capital for the taxable year—

(i) Stock of one member of the affiliated group held by another member of the group at any time during the taxable year shall be determined to be stock held with a basis other than cost if—

* * * * *

(B) Such stock is held with a basis fixed by reference to its basis in the hands of a preceding owner, but not including—

* * * * *

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